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CITATIONS

262801—40

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 402

MAIN AND MCKINNEY BUILDING COMPANY OF HOUSTON, TEXAS, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 32) is unreported. The opinion of the Circuit Court of Appeals for the Fifth Circuit (R. 42–44) is reported in 113 F. (2d) 81.

JURISDICTION

The final decree of the Circuit Court of Appeals affirming the decision of the Board of Tax Appeals was entered July 3, 1940 (R. 44). Motion for

rehearing was filed July 24, 1940 (R. 45), and denied August 2, 1940 (R. 57). Petition for a writ of certiorari was filed September 6, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer purchased a leasehold with an unexpired term of 98 years agreeing to pay $10,000 a year for 25 years as part consideration. Are those annual payments deductible from gross income as rent, or should they be capitalized as part of the cost of the leasehold to be recovered through deductions for exhaustion?

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments re-

quired to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(l) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * *

* * * * *

(U. S. C., Title 26, Sec. 23.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23 (a)–1. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under the provisions of articles 23 (b)–1 to 23 (q)–1. * * * Among the items included in business expenses are * * * rental for the use of business property. * * *

ART. 23 (a)–10. *Rentals.*—If a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. * * *

STATEMENT

The facts, as stipulated (R. 23–27), are substantially as follows:

Main and McKinney Building Company, the taxpayer, was incorporated under the laws of the State of Texas on October 5, 1925, with its principal place of business at Houston, Texas (R. 23). Its accounting period is the calendar year (R. 23).

On March 12, 1926, taxpayer purchased the unexpired term of a leasehold on property at Main and McKinney Avenue, Houston, Texas (R. 23). The original lease was executed on or about April 3, 1925 (R. 14), and expires April 1, 2024 (R. 24).

A copy of the contract under which taxpayer acquired the leasehold may be found at pages 14–21 of the record. Article I of the contract provides as follows (R. 14–15, 24):

> Now Therefore: Main Realty Company, hereinafter referred to as Grantor, for and in consideration of the sum of *Sixty Thousand Five Hundred forty-seven 30/100* dollars to it in hand paid by Main & McKinney Building Company, and the payments and obligations hereinafter mentioned, does hereby transfer, assign and convey unto the said Main & McKinney Building Company, a corporation with its principal office in Houston, Harris County, Texas, hereinafter referred to as Grantee, the above-described lease, together with all rights, titles and options conferred thereby and existing thereunder, together with the

leasehold estate in the above-described property created thereby and existing by reason of the above-mentioned lease contract.

The obligations assumed and payments to be made to Main Realty Company are set forth in Article II of the contract as follows (R. 15–16, 24–25):

> The Grantee does hereby agree to pay the rents and all other payments, taxes, assessments, levies and governmental charges of all and every kind as specifically and generally set out and described in the lease from Binz and Settegast and required to be paid by Lessee in said lease and does agree to perform all of the obligations required to be performed by Lessee in said lease, and in addition thereto does hereby agree to pay to Grantor, as additional rent, and secured in like manner as is provided for security for rent under said lease, the sum of ten thousand dollars ($10,000.00) per year for twenty-five (25) years beginning September 1st, 1926, the same to be paid in Gold Coin of the United States of the present standard of weight and fineness, payable annually in advance. Said payments to be made to D. & A. Oppenheimer, Bankers, San Antonio, Texas, for account of Grantor, its successors and assigns, and payment to said bank and its receipt therefor shall be full acquittance for such amount, and such payments shall be made without any deduction or abatement whatever from any cause whatever, except

> income or estate or inheritance or other similar taxes assessed against the Grantor, which, or either of which, of the excepted taxes shall be paid by Grantor. It is the intent and purpose of this agreement that Grantees shall do and perform all and every the conditions, requirements and obligations of the original ninety-nine-year lease, and that the amount of rental hereinabove required to be paid by Grantee shall be absolutely net to this Grantor, and without any charge of any kind or character whatsoever against Grantor or the demised premises, except income or estate or inheritance or other similar taxes assessed against the Grantor, which, or either of which, of the excepted taxes shall be the obligation of Grantor.

In its income tax returns for the years 1934 and 1935 as well as for the years 1926–1932, the taxpayer deducted the $10,000 annually as rent (R. 25–26).

For the years 1934 and 1935 the Commissioner asserted a deficiency against the taxpayer arising from his determination that the annual payments of $10,000 were not rent but part of the cost of the lease, and hence that only an aliquot part thereof, based on the number of years the lease had to run, was deductible in each year (R. 11, 12). The Board approved the Commissioner's determination (R. 32–33), and the Circuit Court of Appeals affirmed (R. 42–44).

ARGUMENT

The petition does not allege any conflict with decisions of this Court or of any other circuit court of appeals. The decision below is plainly correct and does not call for review in this Court.

Whether the annual payments of $10,000 be regarded as the cost of the leasehold, or whether they be regarded simply as "advance rentals," they should be spread over the life of the lease, rather than being deducted in full during the first 25 years. See Art. 23 (a)–10 of Regulations 86, *supra*. There is nothing in *Davis* v. *Vidal*, 105 Tex. 444, relied upon by petitioner (Pet. 15–20), which either requires or even suggests the contrary. That case merely involves the question whether the original lessee's right to repossession in the event of the assignee's default renders the arrangement between them a "sublease" rather than an "assignment." That case has no bearing upon the question here, whether the $10,000 payments, whatever label they may carry under state law, have the quality of being a capital outlay under the federal income-tax statute to be amortized over the term of the lease. Cf. *Morgan* v. *Commissioner*, 309 U. S. 78, 80–81; *Lyeth* v. *Hoey*, 305 U. S. 188, 193; *Burnet* v. *Harmel*, 287 U. S. 103, 110.

CONCLUSION

The decision below is correct, and is not in conflict with any other decision. This case involves a pecul-

iar set of facts, and does not present a question of general importance. The petition should be denied.

Respectfully submitted.

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